



Labor Market Impediments to Stability in Iraq

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Introduction

In a charged environment of political uncertainty, rampant crime and random violence, Iraq's economic problems have often been viewed as secondary. In part this misconception stems from the fact that Iraq's economic situation might appear to have improved substantially since the overthrow of Saddam Hussein, and in many ways it has. Karada, Baghdad's main shopping street, boasts a thriving market in expensive consumer items, some of which had been unavailable for years. Rising salaries and incomes have enabled many Iraqis to repurchase household items sold during the sanctions-era of the 1990s.^[1]

No doubt much of this new found consumer good boom can be attributed to the policies to the Coalition Provisional Authority (CPA). Its September 2003 decision to increase substantially public sector wages benefited at least one million employees. Anti-inflationary policies made possible by the independence granted Iraq's Central Bank by the CPA have helped stabilize inflation in the 20 to 30 percent range. The new Iraqi currency has been surprisingly stable, in large part due to the CPA's efforts at converting and unifying the currency.

Still, however welcome, consumption growth and relative price stability are only a first start. Alone, they will not assure future prosperity. They do not represent the type of reconstruction required by an economy devastated by decades of mismanagement, war, sanctions, and rampant criminal activity. As of early 2005, insufficient progress has been made in such critical areas as major public construction works; factories by and large, especially the large state-enterprises are deserted or operating well below capacity. Consumer spending has done little to reduce unemployment, and as much as 60 percent of the population is still dependent on food rations for survival.^[2]

When coalition officials arrived in Iraq after the war, they planned on turning Iraq into a free market economy—a model for capitalism in the Middle East.^[3] As part of this plan, they expected private companies, both foreign and domestic, to play a leading role in jump-starting the economy. Free market incentives driven by pent-up demand and a massive aid-financed reconstruction program were thought to be sufficient to induce a massive wave of investment and hiring of Iraqi workers.^[4] But violence, crime, and uncertainty over the future have undermined investor confidence, preventing market-driven mechanisms from playing their anticipated role.

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Slow job creation in the public sector, stemming in part from the de-Ba'athification program,^[5] the limited productive capacity of agriculture and the formal private economy to absorb surplus labor combined with rapid population growth and deteriorating skills appears to be creating, in addition to outright unemployment estimated at anywhere from twenty-five to seventy percent, a vast pool of workers toiling at extremely low wages in the country's expanding informal economy. Many of Iraq's current economic difficulties are fairly typical in strife-torn countries.^[6]

The sections below assess the dynamics of Iraq's urban informal economy. Emphasis will be on the country's labor market dynamics. What demographic factors are currently at work to expand this important component of the economy? What are the main areas and characteristics of Iraq's contemporary informal economy? Based on the answers to these questions a final section assesses what might lie in store for Iraq's urban informal economy.

Labor Market Dynamics

Labor markets ultimately depend on a country's demographic dynamics. Even without the destruction brought on by wars, sanctions, and mismanagement, contemporary Iraq would likely have a large and growing informal economy. Over the years rapid population growth together with slow job creation has had two main consequences, outright unemployment and expanding workers drifting into income earning informal activities. However the precise magnitudes of these patterns are difficult to estimate.

First, our picture of Iraq's demographic structure and change over time is far from perfect.^[7] There are serious doubts about the population figures produced in Iraq's last official census conducted in 1977. That census suggested a population of 21.7 million.

Working figures obtained from the now dissolved Coalition Provisional Authority (CPA) and based on those produced by the Ministry of Planning suggest that excluding those resident in the three self-ruled Kurdish provinces, the country's population in 2001 was 21.5 million. Rough estimates for these three provinces would indicate that some four million people resided there in 2001.

Second, the rate of population growth is also unknown. It has likely increased steadily since 1993 when it was only 1.9 percent, at a time when many middle class Iraqis were leaving the country. The International Monetary Fund^[8] estimates the current figure of 2.7 percent per annum which, given the high rates of population growth common throughout the Middle East, seems reasonable.

Third, albeit to a lesser extent, the precise extent of urbanization is also unclear. For a developing country, Iraq appears very urbanized. The growth of cities has been rapid ever since the adoption of state planning policies in the 1960s designed to develop industry and to manage the agricultural sector. In fact, the country is likely to have experienced an accelerating trend of migration to urban centers from less prosperous rural areas. Rough estimates suggest that Baghdad and its surrounding province accounted for more than thirty-one percent of the population at the time of the 1997 census. A rough figure of the country's urbanization is seventy-five percent of the population now residing in towns. Data from the World Bank^[9] suggests the country's urban population grew by approximately five percent a year between 1970 and 2000.

Fourth, a benchmark period for "normal" economic conditions in Iraq is hard to specify. Prior to the invasion of Kuwait which triggered the sanctions, Iraq had been in a war with Iran for the best part of the 1980s. Employment patterns were heavily influenced by that war and the subsequent period of sanctions in the 1990s. For what it's worth, the 1987 data suggests the country is essentially a service economy with that sector the largest employer by far, accounting for nearly half of all workers. Nearly a quarter of all workers were employed by the government, and a large proportion of those by the armed forces and the security services. Sectors with significant

numbers of the self-employed, such as agriculture and wholesale and retail trade accounted for a small proportion of the labor force, around twelve and six percent, respectively.[10]

As noted above, this picture of Iraq's population is roughly consistent with the more documented trends found elsewhere in the Middle East,[11] with the country's labor force patterns roughly similar to those found in the region's other oil rentier states.[12] In terms of the demographics, the present population of the Middle East and North Africa is relatively young. Nearly thirty-six percent of region's population is less than fifteen years old. An additional 21.5 percent are between fifteen and twenty-four years. The young age structure of the region's population is the result of major demographic changes that have taken place in the post-World War II period. Historically the region maintained higher rates of fertility than most other developing regions. Between 1950 and 1970, fertility rates in the region averaged about seven children per women. As expected, high fertility rates over time led to rapid rates of population growth and a rising share of the youth population. Between 1950 and 1975 the region's population doubled. It had more than tripled by 1990.

Fertility rates in the region began a slow decline in the 1970s, and have undergone significant reductions since the late 1980s. Still the persistently high fertility rates have implied that the region's age structure would exhibit an extended and large youth bulge.[13] The youth population grew at an average rate of about 3.2 percent a year between 1970 and 2000. Clearly, the relative size of the youth bulge is exerting direct pressure on labor markets throughout the region—especially in Iraq. What makes the youth bulge significant is its timing, interaction with other socioeconomic trends and implications for employment creation.

For most of the Middle Eastern countries, the emergence of the youth bulge coincided with the collapse of oil prices in the mid-1980s and the weak growth performance that characterized afterwards.[14] Iraq's case was even more severe with the sanctions period of the 1990s further dampening the country's job creation potential. The normal pattern of unemployment is one whereby the incidence is considerably higher among youth, mostly first time job seekers. For this group unemployment rates are commonly twice that of the overall labor force. In Iraq's case a plausible figure for youth unemployment is sixty percent, double the commonly quoted figure of thirty percent overall unemployment. There is little doubt that the region's young first-time job seekers bore the brunt of high unemployment and stagnant real wages in the 1990s. This continues to be the case today, especially in Iraq.

The other side of the demographic pressure on labor markets is the pattern of employment in the formal sector. With significant pay increases for public workers and little private sector employment a dualistic labor market is being created. Higher wages and non-wage benefits, together with job security in the public sector, has resulted in a disproportionate number of Iraqis seek work in this sector as opposed to the private sector.

At the same time, the attractiveness of public sector employment, especially for those with a secondary education, raises many workers' reservation wage for the private sector. The subsequent inability to attract qualified workers needed to direct and supervise those with limited education and skills further stifles private sector expansion. This process, also dominant in Iraq starting with the Ba'athist rise to power in the 1960s, and continuing up to around 1988,[15] was previously able to avoid high levels of unemployment and growing informal economy through the rapid expansion of the public sector. Starting with greatly constrained finances in the sanctions period, slow public sector employment growth has simply left the unemployed or forced to drift into the informal sector. The result is a two-tier system that overprotects formal-sector public employees and under-protects workers in the informal sector. While an extreme case in Iraq, this pattern of labor market distortion is found throughout the Middle East.[16]

In sum, even without the wars and sanctions, it is highly likely that Iraq would have a sizable informal economy at this point in time. Those events, together with the instability and insurgency

following the overthrow of Saddam Hussein have only reinforced long standing trends in the country's labor markets.

Human Capital in Iraq

The gaps, noted above, in skills needed for dynamic private sector growth are deep seeded. Many deficiencies can be traced back to the socialist development plans adopted in the 1960s. On the demand side, Iraq adopted a full employment policy in 1968 committing the public sector to provide jobs for each and every individual regardless of market forces. The result was over employment in the public sector. At the same time the private sector was denied a normal flow of technically skilled secondary graduates and young university graduates. This policy created sharp manpower imbalances leading to inflationary pressures and lower overall national productivity.^[17] Yet the program was sustainable with oil revenues camouflaging the economy's underlying structural weaknesses.

In addition, and especially prior to 1970, economic development plans in Iraq were founded on the idea of investing in physical plant and infrastructure and did not give development of human capital a high priority. Labor force needs were not spelled out, nor were they based on any realistic estimates of the skill requirements implicitly required by the planned capital investments. The result was a shortage of skilled workers in certain technical fields and an excess in others.^[18]

The 1971-75 and 1976-80 National Development Plans attempted to overcome these deficiencies. The 1971-75 Plan stressed that "labor force planning must go side by side with economic development planning." Planners began to recognize that no effective manpower and employment planning could be performed independently of overall national planning.

A somewhat different picture emerges, however, from scrutiny of Iraq 's actual expenditures on education and health. This situation is especially so upon examination of the country's pattern of defense expenditures and in comparison with Iran and with other Arab countries, particularly during the 1980s:^[19]

- Government expenditures for education on a per capita basis expanded by 17.28 percent between 1974 and 1979, roughly the same rate achieved by Iran. While this figure was quite high, it was still considerably below the rates achieved by other Arab countries during this period.
- Health expenditures expanded more rapidly than in most developing countries, increasing at 23.63 percent during the late 1970s.
- However, during the early 1980s, there was a major contraction in educational expenditures, averaging a decline of 5.74 percent per annum on a per capita basis during 1979-84. Comparable figures for Iran showed an increase of 3.69 percent.
- The share of educational expenditures in gross national product (GNP) in Iraq increased slightly from 3.12 percent in 1974 to 3.19 percent in 1979 and (largely as a result of declining GNP) to 3.40 percent in 1984. Comparable figures for the Arab countries as a whole were 3.86, 5.00, and 5.34 percent, respectively.
- Iran's performance during this period was even better; its commitment to educational expenditures increased from 3.10 percent in 1974 to 7.51 percent in 1984.
- As might be expected, a major cause of the decline in educational expenditure during this period was Iraq's massive increase in military expenditures. These expenditures

increased by 34.25 percent per annum on a per capita basis during 1979-84, compared with an increase of 14.6 percent by Iran and -0.04 percent for the Arab countries as a whole.

- Iraq's health expenditure also suffered during the early war years, decreasing at an average annual rate of 6.93 percent per capita. In relation to Iran, Iraq's Health expenditures have been considerably below Arab standards, increasing from \$7.28 per capita in 1974 to \$21.69 in 1979 only to decline to \$14.69 in 1984. Comparable figures for the Arab countries as a whole were \$33.57, \$68.58, and \$97.48.

The situation only deteriorated further during the period of sanctions in the 1990s. In addition to further cutbacks in the funding of public education, gender gaps began to grow because of families' economic need; when given a choice to send a male child or female child to school, most chose to keep the girl home. UNESCO estimates that in 1987 about 75 percent of Iraqi women were literate, but by the end of 2000 that number had shrunk to 25 percent and that Iraq had the lowest adult literacy levels in all of the Middle East.[\[20\]](#)

In short, Iraq fell considerably behind neighboring Arab countries in its commitment to human capital formation. A recent survey[\[21\]](#) by Zogby International is suggestive of some of the areas of training and skill formation that the government will have to give top priority. The interviews conducted over the period October 17 to December 3, 2004 of 454 Iraqi owners or managers of small-to-medium sized registered businesses (less than one hundred employees) in Baghdad (264 interviews), Irbil (90 interviews), and Hilla (100 interviews) found that:[\[22\]](#)

- The top needs in Iraq's workforce are for more English language training and computer training;
- English training was the top concern in both Hilla and Irbil, where two-in-five business operators (38 percent) say it is the area that needs to be addressed the most in the Iraqi workforce;
- In both cities computer training ranks second with three in ten (30 percent in Hilla and 32 percent in Irbil) citing this as the top need of the Iraqi workforce;
- In Baghdad however, this percentage drops to 17 percent—placing it fourth behind a better work ethic (25 percent), computer training (22 percent) and a better education system (19 percent); and
- Among Shiites, computer training places first (31 percent); among Sunnis, English training is the top concern (33 percent). Kurds are more likely than other ethnic groups to call for greater English Language training (34 percent) while Arabs split between more English training and more computer training (24 percent and 25 percent, respectively.)

At the same time expansion of private sector activity is constrained by shortages of appropriately trained workers, the educational system has declined through years of neglect and destruction and will take years to renovate and restore. According to UNICEF of 15,000 academic buildings in Iraq eighty percent are damaged and in need of repair, forty percent require major reconstruction work and nine percent require complete demolition and rebuilding.[\[23\]](#) The Iraqi Ministry of Education has set a deadline of four years for the completing the rebuilding of the system task. According to USAID, which has provided the bulk of the funding for the effort, in the region of 2,400 schools have already been renovated.

But reconstruction alone is not enough: Iraq's growing population means more young minds to school than ever before. In 2000 there were 3.6 million Iraqis of primary school age. Today there are 4.3 million. The government is struggling to keep up. Overcrowded classes are the norm, and many schools have been forced to run two or three shifts a day, at the toll of less classroom time for the students. UNICEF estimates that a further 4,500 new schools are needed if the class sizes are to be brought down to an acceptable level.

The picture is a bit brighter for students at the university level. For years universities had been unable to keep their libraries up to date with the latest publications and journals, and many were looted in the security vacuum immediately following the overthrow of Saddam Hussein. Since the fall of Saddam Hussein, however, tons of books, periodicals, and lab equipment have been donated to Iraqi universities. USAID has also awarded five grants, worth \$20.7 million to forge partnerships between Iraqi and U.S. universities. So far the results have been positive: eighty-three percent of Iraq's university students returned to campuses in 2003.

The fact remains, however, that spiraling costs for security, construction materials, and labor are restricting the amount that the government can realistically achieve in the reconstruction of the education system in the short term: for the time being the main objective will be to ensure that Iraq's present instability interferes as little as possible with the education of the country's children.

Implications for the Urban Informal Economy

Until significant progress is made restoring security as well as in upgrading the skills of the workforce it will be difficult for the private sector to begin absorbing laborers from the informal economy. In the meantime the informal economy is the main engine of job creation in Iraq. The supply and demand forces in the labor market noted above have a number of consequences for the informal economy. The obvious one of course is that the main areas of labor absorption will likely entail workers drifting into the various service sectors such as trade and merchandising as well as light, labor intensive manufacturing for local needs and consumption.

The labor markets also have implications for the types of workers entering the informal economy. Petty trading and unskilled casual labor are "bottom line" activities which have virtually free entry. There appeared to have been a dramatic rise in the number of people, including young children who were involved in these activities to help support their families. Many take on back-breaking jobs, earning little money, often only several dollars a day.

In its boom period of the 1970s and early 1980s, Iraq boasted a large middle class. Inflation brought on by economic mismanagement impoverished much of this group. Successive wars have killed many breadwinners, leaving widowed mothers and orphaned children. Iraq's child labor woes therefore predate the overthrow of Saddam Hussein. Indeed, just before the war, the White House cited "instances of forced labor" among children and "military training camps for children" among its top ten reasons for deposing Hussein. But since then life has become even more grueling and dangerous for many of Iraq's youngsters.[\[24\]](#)

- A study by a Norwegian Institute, the Fafo Institute of Applied International Studies found the percentage of Iraqi children ages six months to five years suffering from malnutrition has nearly doubled to 7.7 percent from four percent in March 2003.[\[25\]](#)
- Iraqi schools have the potential for six million students. In a country where two-thirds of the population is under twenty-five the question on parents' minds is whether the government can keep children safe. Citing heightened security concerns the interim government delayed the traditional early September opening of schools.[\[26\]](#) Schools finally opened October 2nd after a two week delay.[\[27\]](#)

- Security fears plague many parents of small children in Baghdad, where kidnapping is on the rise. Almost half the girls were not going to school at the end of the term in June 2003.[28]

In theory, Iraq has some of the most progressive child labor laws in the region. Iraqi law bars children under fifteen from working and demands strict worker safety conditions for those fifteen and over. By law, working children must receive the same rights and benefits as adults as well as regular health checkups. They must receive at least a third of an adult salary and cannot work more than several hours a day.

In practice, however, officials admit that few employers, parents or children abide by such regulations. As a result, statistics about child labor in Iraq are sketchy and the insurgency has prevented any official survey of the condition of children's lives.[29] Again, international comparisons and antidotal accounts provide some clues of the plight of children in contemporary Iraq. Fifteen percent of children ages five to fourteen work in the Middle East and North Africa according to UNICEF. In 2000 the International Labor Organization estimated that there were 66,000 "economically active" Iraqi children between ages ten and fourteen out of a total population of twenty-five million.[30] Hundreds of thousands of children in Iraq are prone to injury, abuse, and exploitation, according the United Nations Fund for Children (UNICEF). Children below fifteen years of age are nearly twelve million, or forty-four percent of the country's twenty-seven million.[31]

In another study, The Children's Parliament on the Rights to Education found in 2000 that one out of four Iraqi children between six and twelve were not enrolled in school, nearly four times the average in the Arab world. But few statistics are available on the extent and range of child labor in contemporary Iraq. By all accounts in poverty-stricken neighborhoods of Baghdad such as Sadr City, the vast majority of children have jobs, often doing back breaking manual labor for a few dollars a day.[32]

UNICEF sees street children as a growing problem. "Prior to the 1991 Gulf War, the problem simply did not exist. There was a very high rate of children in the schools and no child labor. The international economic blockage enforced that year to put pressure on Saddam Hussein took children out from school into the labor Market."[33] "Poverty is pushing children into the streets. They just need to make their living and bring home some dinars at the end of the day." [34]

In major cities through the south like Basra and Karbala, seventy to eighty percent of children interviewed by UNICEF after the war were working, and in Najaf, fifty percent of children were not in school. USAID has started a pilot program in six cities to draw children back to school, but it serves only 650 children among the millions who have dropped out. Sad accounts of child labor abound.[35]

Accounts of income earned by children vary. Representative figures are:[36]

- Car mechanic—working 7.5 hour shifts, six days per week, for around \$10 per day in wage plus tips;
- Water—working from 8:00 a.m. to 11:00 p.m., for around \$23 per week; and
- Car washer—working six to nine hours per day, for around \$3 to \$4 per day.

Many children also drift into areas such as casual labor and petty trading where the range of incomes is considerably greater.

In fact there has been a dramatic rise in all groups of low income earners engaging in "bottom line" economic activities such as street vending. There is free entry into these activities so long as a person is reasonably healthy. To many, street vending is part of a coping strategy to

supplement income earned in one or two other jobs. Most however have no other jobs and can only support their families by selling goods on the street.[37]

Informal Activities

Within the informal economy encompasses a diverse set of activities. A useful classification combines their economic sophistication with the needs they meet [Table 1]. Clearly, for many Iraqis survival is the main motivation for entering the informal economy. This is certainly one of the main reasons for the expansion of this sector. Clearly a certain number of informal activities provide a specific and immediate answer to poverty by allowing the most underprivileged sections of the population to enter the labor market, albeit in a precarious way. In addition, the informal sector opens the way to consumerism, not only for the poorest but also for the masses and the middle class. For the last two groups, resorting to the informal sector is a means of saving that allows them to buy higher quality imported goods.

Table 1: Iraq - Summary of Activities of the Informal Economy

Survival Response to Poverty:

Flea markets, street sellers of diverse, small quantity goods.

Foods

Used clothes

Cigarettes

Candies

Bread

Response to Traditions and Food Needs:

Small scale food production, bakeries, pastries

Seamstresses Hairdressers

Small scale metal work

Textiles and leather

Potters

Response to Modern Aspirations:

Modern sector services

Small-scale manufacturer

Repair and recovery services

Furniture

Carpentry

Car repair

Plumbers

Electrical supplies

Transport

It is not clear if the children who work as petty traders take up these activities outside of school hours, or whether they have dropped out of school altogether. In economic terms, these activities,

such as selling from a carton of cigarettes, are extremely low value added and are mainly of a marginally redistributive nature. The fact that a large number of people both adults and children, are prepared to spend large amount their time trying to earn a narrow margin on a transaction of small turnover, indicates that this is not a positive economic opportunity, but a measure of some desperation.

Another manifestation of the informal economy is the development of special markets for the exchange of used goods that began cropping up in many towns across the country during the period of sanctions. These markets are usually held on specific days of the week. They often attract very large numbers of buyers and sellers. The items traded at these markets range from bulky household durable goods such as stoves and refrigerators, down to used items of clothing, electronic appliances and books. As in the case of petty vending many transactions in these markets involve extremely low turnovers. Here too, the willingness of people to spend the entire day hoping to make a narrow margin on these transactions reveals the absence of alternative opportunities for remunerative employment.

Street vending, therefore, can be anything from a survival strategy—a desperate search for a subsistence income—through petty capitalism, or the diversification of larger merchants to boost demand and achieve a higher turnover. Most street operations are much smaller in scale than fixed stores or supermarkets in off-street locations, but a few are quite substantial, ranging from truck borne mobile stores to big fixed stalls in strategic high demand locations. The income distribution of street vendors is highly skewed with a very few making quite high incomes, comparable to those of successful storekeepers and career professionals, an most making relatively low incomes comparable to those of unskilled manual workers.

Just as street vending activities vary greatly in scale, timing, location, and remuneration, similar differences exist in terms of workforce and types of goods and services. The significance of women, men, girls, and boys as street vendors varies considerably from city to city. Goods may be narrowly focused on a few lines, for examples, newspapers, and candy or spread across the whole gamut from cooked foods, groceries, and hardware through clothing and electrical appliances. Shoe shining, hair cutting, document typing, and the repair of shoes, clothes, bicycles motorcycles and cars are all common street services. As noted in [Table 1](#) above, these activities can be organized into different groups depending on the circumstances of the seller and sophistication of product.

The Iraqi government does not appear to have formed a comprehensive policy toward street vendors. Vendors disappear when they think thy may be subject to prescription and they reappear when the inspectors and police move on. When asked to move away from a congested spot, they often obey and then shift back again in sort time. When persistently harassed in one location, they often move on to another location. The key to any future policy towards the sector will be one of tapping the entrepreneurial spirit of vendors and channeling it towards higher value added activities.

Assessment

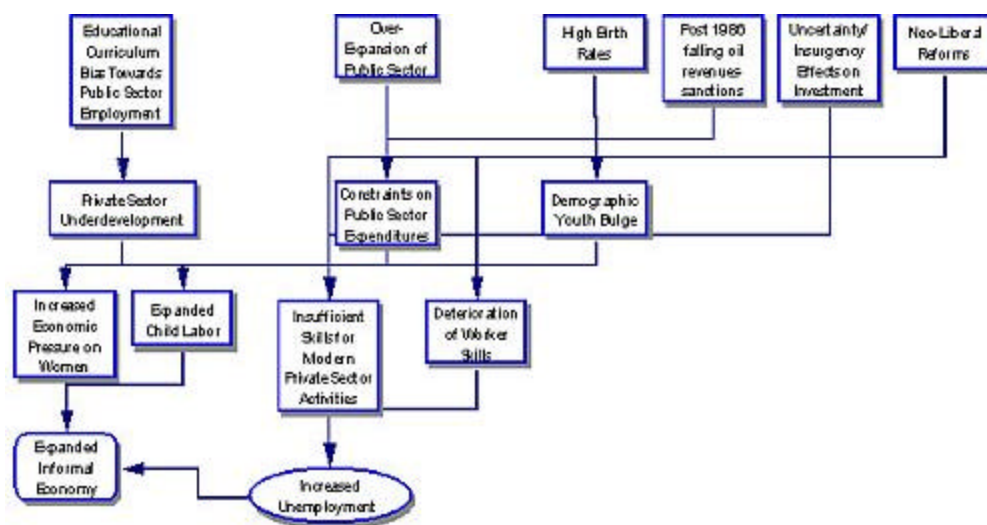
There are three main schools of thought regarding the relationship between the formal and informal economies:

- The dualists: the informal economy is a separate marginal economy not directly linked to the formal economy, providing income or a safety net for the poor.[38]
- The structuralists: the informal economy is subordinated to the formal economy. In order to reduce costs, privileged capitals seek to subordinate petty producers and traders.[39]

- The legalists: informal work arrangements are a rational response by micro-entrepreneurs to over-regulation by government bureaucracies.[40]

Of these interpretations, the Iraqi informal economy appears closest to the dualist interpretation. Iraq's contemporary informal economy is largely a function of fundamental supply and demand factors summarized in [Figure 1](#): (a) a youth population bulge, (b) a long-standing state employment program providing incentives for employment in the public, but not private sector, (c) a workforce of diminished skills following a long period of sanctions, (d) little private sector growth stemming from the instability following the overthrow of Saddam Hussein and (e) the openness to trade (neo-liberal reforms) made many potentially profitable firms unprofitable. In turn, the lack of a sizable private sector reduces the links often found between the informal and formal economies in many developing countries.

Figure 1: Dynamics of Iraq's Labor Markets and Informal Economy



Because the informal economy is largely the result of a convergence of powerful long-run demographic and economic forces, it will be a fixture for some time to come. At best it may evolve over the next several years with some progression if the government gains greater control over the security situation, and private sector investment begins to pick up. Clearly, success in this regard will be critical in establishing stability in Iraq.

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